

10-4

CAFTA's Impact on U.S. Raw Cane Sugar Trade

By:

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Executive Summary

Sugar trade has been at the heart of many international trade agreements. Sugar is one of the largest agricultural industries in the United States and thus is a sensitive commodity. Groups around the world have a vested interest in how the United States handles sugar production and trade. The latest change to the U.S. sugar program was the passage of the Central American Free Trade Agreement (CAFTA).

The United States imports raw cane sugar using a tariff-rate quota (TRQ) system. This trade regime sets in place specific tariffs within a set volume of sugar. If an exporting country exceeds the given quota within the allotted TRQ, the country faces a second-tier (and much higher) tariff. Owing to past trade agreements, such as the North American Free Trade Agreement (NAFTA), the Generalized System of Preferences, and the Caribbean Basin Initiative, many countries already have duty-free access, within a set volume, to the U.S. sugar market.

The pre-CAFTA TRQ system was criticized for creating artificial trade barriers and excluding low-cost producers from exporting raw cane sugar to the United States. The sugar-exporting countries that participate in the TRQ regime are different from those who participate in the tariff- and quota-free U.S. sugar import programs. These differences may serve to illustrate some of the trade imbalances within the U.S. TRQ system.

On August 2, 2005, U.S. President George Bush signed DR-CAFTA,¹ comprising Costa Rica, the Dominican Republic, El Salvador, Guatemala, Honduras, Nicaragua, and the United States. This agreement will affect both sugar exports from these Central American countries and the U.S. sugar program.

It is believed that CAFTA will help Central American countries gain access to the U.S. sugar market. CAFTA may also affect the price of raw cane sugar in the United States, marketing allot-

ments to U.S. sugar processors, and U.S. sugar industry jobs. Many U.S. sugar farmers and processors oppose CAFTA, fearing that the removal of trade barriers set in place under the TRQ regime will lead to a loss of U.S. sugar-producing jobs and an influx of low-cost sugar from abroad. Another question is whether or not imports from these Central American countries will affect other sugar-producing developing countries that have preferential access to the U.S. market from other trade agreements.

Like most trade agreements, however, CAFTA contains a safeguard clause:

The Agreement also includes a mechanism that allows the United States, at its option, to provide some form of alternative compensation to CAFTA country exporters in place of sugar imports. That allows the United States to restrict imports eligible to enter under the CAFTA if the U.S. sugar program is threatened, and instead provide equivalent benefits to the CAFTA countries to make up for the lost access (USTR 2005).

Your assignment is to develop a set of policies under CAFTA that will satisfy all stakeholders. Discuss the policy issues with regard to alternative import mechanisms under CAFTA and which stakeholders might support or resist these policies. Justify your recommendations, and assess the consequences for each stakeholder group.

Background

The Tariff-Rate Quota System for Raw Cane Sugar

Sugar can enter the United States through a variety of paths and policies, although the majority of U.S. sugar is imported through the use of tariff-rate quotas. TRQs were established in 1994 in the Agreement on Agriculture through the Uruguay Round in an effort to abide by the General Agreement on Tariffs and Trade (GATT) regulations. The previous import system, direct quotas, was said to be in violation of GATT Article XI,

¹ After the Dominican Republic joined CAFTA in 2005, the agreement has often been known as "DR-CAFTA," but in this case study, it will be referred to as simply "CAFTA."

which prohibited quantitative import restrictions. The TRQ system is a two-tiered tariff; a certain number of imports (called "in-quota" imports) are allowed into the United States at a low tariff, and any number of imports above that initial amount are subject to a much higher "out-of-quota" tariff (ERS/USDA 2005). This system is designed, on paper, to reduce market barriers and eliminate the direct quota placed on many goods.

Other provisions within the TRQ system include a minimum market access requirement for imports. The United States was required to import at least 3 percent of its domestic consumption of sugar for six years; in 2000 the rule was changed to 5 percent of domestic consumption. At that point the United States already imported more than 5 percent of its domestic consumption of sugar, however, so the decision about whether to increase its in-quota volume of sugar imports was voluntary.

Sugar TRQs within the United States are based primarily on historical trading patterns. The TRQ in-quota number is based on 40 countries' patterns (or "Olympic market shares") during 1975–1981. This was a period of extremely high world sugar prices during which many countries with high producer costs were able to remain competitive. During these years, exporters with the largest share of the U.S. raw cane sugar market included Australia, Brazil, the Dominican Republic, and the Philippines. The relative proportion of sugar exports from various countries in 1975–1981 was nearly identical to the proportion of TRQ allotments distributed to sugar-producing countries today.

The implementation of TRQs for sugar (and other tradable commodities) can have three effects. First, the in-quota tariff can be the binding constraint, causing even fewer imports than those under the original quota system. Second, the TRQ can act as a two-tiered tariff if there are over-quota imports of a specific good. Third, the in-quota tariff can have the same net effect as the direct quota, leading to the import of the same volume of sugar as under the original quota system. If the in-quota tariff proves to be the binding constraint, many scholars worry about the possibility of "underfill," which occurs when the exporting country does not fill TRQ allotments; the worldwide average TRQ fill rate hovers around 60 percent (Canadian Agri-Food Trade Alliance 2003).

As a result of NAFTA, substantial TRQ allotments are distributed to both Canada and Mexico. Other countries are given specific in-quota allotments each year, set by the U.S. Department of Agriculture (USDA). For fiscal year 2004, Australia, Brazil, the Dominican Republic, and the Philippines were given the largest TRQ allotments for raw cane sugar, refined sugar, and sugar-containing products. There is also a quantity of sugar under the TRQ system that is available for import on a first-come, first-served basis. By examining patterns associated with sugar trade, it is possible to see some of the effects of a TRQ system. It is probable that TRQs benefit a handful of countries with large in-quota allocations; they may also encourage high-cost producers to increase their exports.

Other than TRQs, sugar can enter the United States through three other programs, which are not subject to quotas or tariffs. The three programs are the USDA's Sugar-Containing Products Re-Export Program, the Refined-Sugar Re-Export Program, and the Sugar for the Production of Polyhydric Alcohol Program.

High-Fructose Corn Syrup

As the demand for sugar decreases in the United States, other sweeteners face increased demand. High-fructose corn syrup (HFCS) is a cheap alternative to sugar and is an ingredient in nearly all soft drinks. The production of HFCS in the United States has been increasing at a faster rate than the production of both beet and cane sugar. In an analysis of the TRQ system, it is important to keep in mind the U.S. production, demand, and imports of HFCS. It is possible that increased use of HFCS has resulted in decreased TRQ sugar imports.

The production of HFCS has skyrocketed in the United States. Between 1980 and the 2000s, U.S. production of HFCS grew from 2.2 million tons to 9.2 million tons. The biggest growth in production, however, came between the years 1975 and 1989, around the same time that U.S. sugar imports had their most significant decline. Production of beet and cane sugar has grown in the United States, but this growth has been slower and not as significant. Consumption of beet and cane sugar has declined, whereas HFCS consumption has increased. The consumption of HFCS increased by more than 1,000 percent between 1970 and 1990.

HFCS can be produced much more cheaply than sugar, so its price is significantly lower than that of sugar. In 2000, for example, raw cane sugar in the United States was priced at 18.4 cents a pound and refined sugar was priced at 24 cents a pound. In contrast, HFCS-42 (a commonly used type of HFCS) was priced at 11 cents a pound in 2000. HFCS is thus a practical replacement for sugar when substitution is possible.

Despite the rise in HFCS, sugar remains a large U.S. industry and TRQs are still the main way the United States imports its sugar. TRQs may not determine how much total sugar gets imported, but they do determine the specific sugar-exporting countries and how much sugar each one of these countries can export into the United States.

Preferential Trade Agreements

In addition to historical trading patterns between 1975 and 1981, a large percentage of U.S. TRQ sugar imports are determined by preferential trade agreements. The United States and other countries have used both regional trade agreements and TRQs to "grandfather" a share of the market for a specific supplier. As many scholars have already documented, however, preferential trade status is often awarded to countries that may not be truly competitive; in fact, some countries in preferential trade agreements might not export a specific good at all if not given preferential trade status. Granting TRQs to high-cost producing countries is just one example of how resources may be misallocated within international agreements. On the other hand, these trade diversions away from some low-cost producers enable other least-developed countries to gain access to potential markets, if they are granted preferential status under a regional agreement.

NAFTA. The North American Free Trade Agreement, established in 1994, has been reducing trade barriers between Mexico and the United States, especially in regard to sugar trade. For the first 15 years of NAFTA, "Mexico's allowable duty-free sugar exports to the U.S. and U.S. duty-free exports to Mexico is the greater of 7,258 metric tons or the quantity allowed under the definition of 'net surplus producer' (production greater than consumption, including consumption of high-fructose corn syrup) (FAS/USDA 2003). According to the agreement, "If either Mexico or the U.S. were

in a situation where they were a net surplus producer during the first six years of the agreement, duty-free access would be provided from the surplus up to 25,000 tons" (FAS/USDA 2003).

Before the implementation of NAFTA, Mexico exported 7,258 metric tons of raw sugar to the United States. By 2001 Mexico exported 116,000 metric tons of sugar (mostly refined sugar) to the United States. At the end of the sixth year (2000), Mexico aligned its tariff regime with that of the United States and implemented TRQ rates that matched U.S. rates. Beginning in year 7 and up to year 15, any tariffs that remain on sugar within this bilateral agreement will be reduced on a straight-line basis to zero (FAS/USDA 2003).

Like all other TRQ allotments, allotments of sugar-cane and sugarbeets must be processed in the country of origin. In this case processing must occur in NAFTA territory to qualify for NAFTA preferences, TRQ in-quota tariff rates, or both (FAS/USDA 2003). Countries within NAFTA (Canada and Mexico) also take part in the Refined Sugar Re-export Program. Given that refined sugar now constitutes the majority of Mexico's sugar exports, NAFTA's effect on raw sugar imports is minimal.

The Generalized System of Preferences (GSP)/Caribbean Basin Initiative (CBI). Approximately 42 countries are given TRQ allotments under the historical method. These 42 countries are geographically dispersed; are small, medium, and large in size; have both large and small sugar yields; and consist of high-cost, medium-cost, and low-cost producers. The Generalized System of Preferences/Caribbean Basin Initiative is an initiative that grants some of these sugar exporters a waiver on in-quota sugar exports to the United States. GSP countries are not permanent, and reviews for eligibility are done periodically, to be renewed by Congress.

Congo-Brazzaville, Côte d'Ivoire, Gabon, Haiti, Madagascar, Papua New Guinea, Paraguay, St. Kitts and Nevis, and Uruguay are currently part of the GSP. These designated countries have been given quota rights that allow them each to export 7,258 metric tons of raw cane sugar to the U.S. duty-free. Note, however, that Gabon, St. Kitts and Haiti do not produce commercial quantities of raw cane

sugar and will likely fall short in fulfilling their quota allocations. Additionally, the CAFTA countries are no longer eligible for GSP status because they are allowed duty-free exports to the United States under CAFTA. Finally, Argentina, Australia, Brazil, the Dominican Republic (now part of CAFTA and previously under the Caribbean Basin Initiative), and Taiwan are not eligible for GSP status.

One program within this Generalized System of Preferences is the Caribbean Basin Initiative (CBI), an expansion of the Caribbean Basin Economic Recovery Act (CBERA Expansion Act) of 1983. Since 1983 the act has been expanded through the creation of the CBERA Expansion Act and the U.S.-Caribbean Basin Trade Partnership Act of 2000 (CBTPA). Thus far, the initiative benefits 24 countries, all of which export sugar into the United States duty-free. This program was originally designed to promote economic development in Central America and the Caribbean islands through private sector initiatives (MAC/USDOC 2000). The goal was to expand foreign and domestic investment in nontraditional sectors, diversifying CBI country economies and expanding their exports. For fiscal year 2004, the United States granted a total of 381,119 metric tons of in-quota allotments to CBI countries, creating the potential for 34 percent of U.S. TRQ sugar to be imported from these countries.

Altogether, the allotments granted to the GSP minimum-quota countries and the CBI countries enable these countries to account for the majority of TRQ sugar allotments given out for import into the United States.

The Policy Challenges

CAFTA

On August 2, 2005, President Bush signed CAFTA, the latest preferential trade agreement incorporating Costa Rica, the Dominican Republic, El Salvador, Guatemala, Honduras, Nicaragua, and the United States (Olson 2005). One of the most contentious issues throughout the CAFTA debate was its potential impact on sugar exports from Central American countries and on the U.S. sugar program.

Tariff- and Quota-Free Import Programs

As previously stated, raw cane sugar can also be exported to the United States under tariff- and quota-free programs. One program is the USDA's Sugar-Containing Products Re-Export Program (FAS/USDA 2004). Here, the United States can buy sugar at the world price to use in products that will later be exported onto the world market. The Refined-Sugar Re-Export Program, another way the United States can import sugar, can "facilitate the use of domestic refining capacity to export refined sugar to the world market" (FAS/USDA 2004). Last, the Sugar for the Production of Polyhydric Alcohol Program accounts for a small percentage of sugar imports. In general, the U.S. government allows domestic sugar refiners to import raw sugar without tariff-rate quotas as long as the refined sugar is (1) re-exported in refined form, (2) re-exported in sugar-containing products, or (3) used for the production of polyhydric alcohol. Through the re-export programs, a refinery can apply to the secretary of agriculture for a license to import up to 50,000 metric tons of raw sugar; the sugar must then be re-exported or transferred to a manufacturer (of sugar-containing products for export) within 90 days of import. These raw cane sugar imports under the re-export program can be replaced with refined sugar from either sugarbeets or sugar cane.

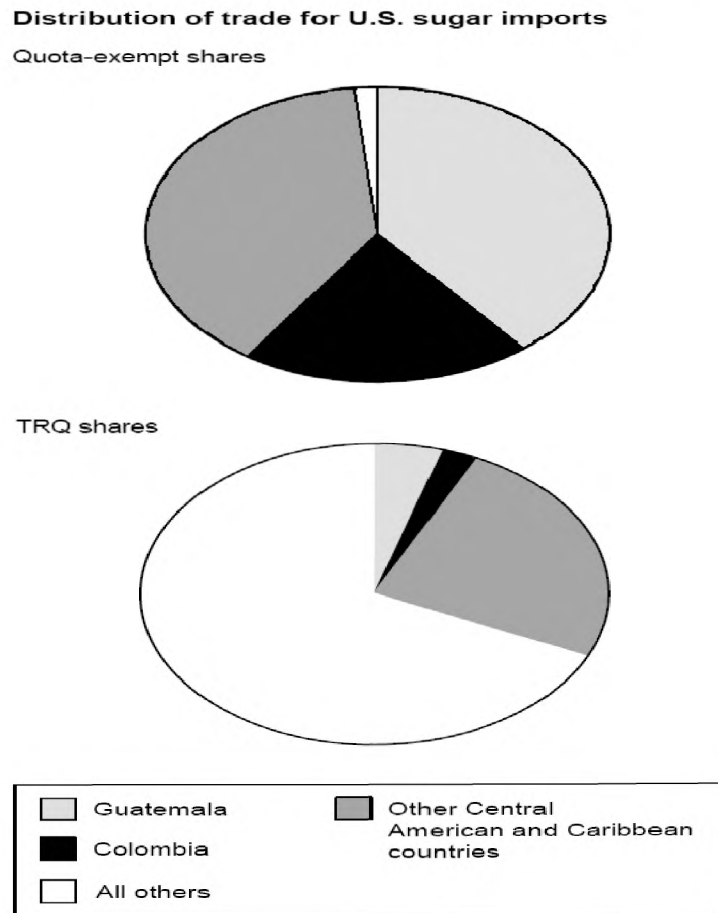
Scholars believe that imports of sugar under the tariff- and quota-free programs may be representative of a free trade sugar model. These programs presumably illustrate what happens to exports into the United States without import restriction. Two general characteristics of the countries exporting under the "free trade" model include their low cost of production and their proximity to the United States. The disparity between those exporting under the tariff- and quota-free programs and those sugar exporters under the TRQ system is clear. This disparity, then, lends itself to a further investigation of the differences between the countries that export to the United States under these two distinct trade regimes.

One method of examining the effects of TRQs is to compare the established TRQ trade flows with the trade flows under tariff- and quota-exempt export shares (which occur primarily under the re-export programs). Below are the general differences between TRQ sugar imports and sugar imports under tariff- and quota-free programs (Skully 2001).

Figure 1 illustrates that when imports into the United States are free of tariffs and quotas, Colombia, Guatemala, and other Central American countries dominate the U.S. sugar market. When TRQs are used, however, Colombia and Guatemala

have small shares of overall U.S. sugar imports; Central American and Caribbean countries hold about one-fourth of the U.S. sugar import market, and "all others" account for slightly less than three-quarters of U.S. sugar imports.

Figure 1: Quota-Exempt U.S. Sugar Imports Compared with U.S. TRQ Sugar Imports



Source: Skully 2001.

Stakeholders

U.S. Stakeholders

Opponents of CAFTA believe that its passage may lead to increased bilateral and regional trade agreements, causing increased duty-free sugar imports into the United States and the eventual destruction of the U.S. sugar industry. The Sugar Alliance, a coalition of sugarcane and sugar beet farmers, processors, and others involved in the sugar industry, was perhaps the most vocal U.S. opponent to the passage of CAFTA. They believe that, in order to eliminate the sugar dumping that occurs in the world market, "the drastic reform necessary to correct the world sugar market can only be achieved in comprehensive, global negotiations in the World Trade Organization and not in bilateral or regional Free Trade Agreements, such as CAFTA" (Suppan 2004). Other opponents include primarily farm-based agricultural groups (excluding the American Farm Bureau) (Suppan 2004).

Other U.S. commodity organizations support CAFTA. President Bush received a letter from 39 commodity and agribusiness organizations noting their support for CAFTA and stating that this trade agreement "will expand U.S. agriculture exports and put U.S. agriculture on an equal footing with its competitors in these markets" (Jurenas 2004). Among the most surprising signatories was the National Corn Growers Association, a member of the Sugar Alliance (Suppan 2004).

Currently, the U.S. sugar system's primary beneficiaries, according to the Government Accountability Office, are domestic sugar farmers and processors (Markheim 2005). In 1996 these groups pulled in about US\$800 million in benefits, and in 1998, about US\$1 billion.

Consumers in the United States will not see much change in the price of sugar from the implementation of CAFTA. Because sugar imports under CAFTA are still relatively small, the U.S. trade protection system implemented on sugar imports

keeps consumer prices relatively high. Yet as more and more sugar is imported into the U.S. duty-free within other trade agreements (such as the U.S.-Mexico agreement), sugar prices to consumers will decrease. If U.S. consumer prices drop as a result of duty-free imports, the United States could maintain its sugar program by increasing subsidies to producers.

Stakeholders outside the United States

Approximately 40 countries export sugar to the United States under the TRQ system. Many of these countries depend on guaranteed duty-free sugar exports. Of these countries, some are high-cost producers, some are low-cost producers, some are geographically far from the United States, and some are within close proximity. Some countries have a high production volume of sugar while others produce only a small amount each season. Changes in the TRQ system will affect the flow of sugar exports from these countries. These countries thus have a stake in how TRQs are allocated, as well as in how trade agreements such as CAFTA will affect their region.

Several factors determine a country's competitiveness on the world market; selected variables are included in Tables 1 through 3. Table 1 lists the low-cost and high-cost producers involved in raw cane sugar production.

Of all the cane sugar producers, Australia and Brazil have the lowest production costs. They are, however, the only countries that still face an in-quota tariff at 0.625 cents a pound. Given that they are the lowest-cost producers and the only countries to face an in-quota duty, they may argue that they should become part of a trade agreement that allows them duty-free access into the United States.

Table 1: Lowest- and Highest-Cost Producers of Raw Cane Sugar (excluding transportation costs), FY 2003/2004

Country	Production Cost Rank	TRQ Allotment (metric tons)	TRQ Actual (metric tons)	Imports under Other Sugar Programs (metric tons)	Production Volume (metric tons)	Miles from United States	In-Quota Tariff Rate (US\$/lb.)
Australia	1	87,402	62,873	0	36,012,000	10,627	0.625
Brazil	1	152,691	143,845	0	386,232,000	4,784	0.625
Colombia	2	25,273	25,273	81,321	36,600,000	2,480	0
Guatemala^a	2	50,546	50,546	172,285	17,500,000	2,056	0
Sudan	2	0	0	0	5,500,000	6,359	0
Malawi	3	10,530	10,530	0	1,900,000	7,769	0
Mozambique	3	13,690	13,690	0	400,000	8,193	0
Swaziland	3	16,849	16,849	0	4,000,000	8,133	0
Thailand	3	14,743	14,743	0	64,407,744	9,038	0
Zimbabwe	3	12,636	596	0	4,100,000	7,788	0
Zambia	3	0	0	0	1,800,000	7,546	0
Ecuador	4	11,583	11,583	0	5,690,895	2,822	0
El Salvador^a	4	27,379	27,379	36,900	4,531,531	2,072	0
Peru	11	43,175	42,882	0	9,550,000	3,365	0
Paraguay	11	7,258	1,649	0	3,300,000	4,655	0
Papua New Guinea	11	7,258	7,258	0	441,600	9,310	0
Panama	11	30,538	30,538	0	1,500,000	2,201	0
Côte d'Ivoire	11	7,258	0	0	1,155,000	4,799	0
Mexico	12	7,258	1,274	0	42,126,500	2,086	0
Jamaica	12	11,583	11,501	0	2,400,000	1,545	0
Barbados	13	7,371	0	0	364,555	2,093	0
Taiwan	14	12,636	41	0	163,000	7,801	0
Saudi Arabia	14	0	0	0	0	6,382	0

Source: Data are from Economic Research Service, U.S. Department of Agriculture.

Note: All production cost ranks were conducted using FY 2003/2004 exchange rates. This rank may change as exchange rates change over time.

^a El Salvador and Guatemala are part of the recently passed Central American Free Trade Agreement.

It is important to compare TRQ allotments with actual TRQ imports to determine whether or not the MFN rate (out-of-quota tariff) is prohibitive and is preventing exporting countries from increasing the volume of raw cane sugar exports to the United States. It may be the case that low-cost producers with high MFN rates are losing U.S. sugar market share to other high-cost producers with lower tariff rates (or no tariffs). Again, this is one way in which trade flows can become distorted; the United States may be favoring imports from countries that are not actually the lowest-cost producers.

Another important factor is the distance of these countries from the United States. Given that Australia is one of the farthest countries from the United States, it may face high transportation costs.

Aside from Australia and Brazil, many developing countries are low-cost producers. Colombia, Guatemala, and Sudan also have very low production costs. Colombia currently has duty-free access to the United States and is filling its TRQ allotment. Colombia also has a substantial volume of sugar exports under other U.S. sugar import programs and is relatively close to the United States. Given that it has such a large volume of sugar exports under the other sugar import programs, Colombia may benefit from increased TRQ allotments.

Guatemala is also a low-cost producer. As part of CAFTA, Guatemala is guaranteed increased raw cane sugar exports to the United States. Of all the CAFTA countries, Guatemala has been allotted the largest increase in in-quota sugar exports.

Brazil produces by far the greatest amount of raw cane sugar. It is a low-cost producer and is relatively close to the United States. The country is given the largest U.S. TRQ allotment and comes close to filling it. In contrast, Saudi Arabia and Taiwan are among the highest-cost producers of raw cane sugar. Many of the high-cost producers have been given substantial TRQ allotments by the United States. Despite their duty-free TRQ allotments, 4 out of 14 of these countries did not export any raw cane sugar to the United States in

2003/2004. Other countries, such as Mexico and Paraguay, did not come close to filling their given TRQ allotments.

Many of these high-cost producers would likely be affected by the removal of TRQs. High-cost producers that fill their quotas will be most affected. Without the given TRQ allotments, these high-cost producers may not be as competitive. If the market becomes inundated with low-cost raw cane sugar from large producers, higher-priced goods will lose market share. High-cost producers located farther from the United States, and where sugar production constitutes a significant portion of agricultural trade, will be most affected.

If sugar trade were liberalized, Panama and Peru could lose a significant share of their relatively large volume of sugar exports, yet the economic impact within these countries is debatable. Both Panama and Peru export less than 2 percent of their countries' sugar production; getting closed out of the U.S. sugar market, then, may not result in any significant negative economic impact.

Table 2 lists the largest producers of raw cane sugar. As one can easily see, a large production volume does not necessarily mean the country is also a low-cost producer. India, for example, is the world's second-largest producer of raw cane sugar yet has high production costs. Mexico is also a fairly large producer of raw cane sugar with one of the highest production costs. Thanks to NAFTA, Mexico has duty-free access to the United States sugar market.

CAFTA Stakeholders

Of the CAFTA countries, Guatemala is the lowest-cost producer, followed by El Salvador (Table 3). Costa Rica, Honduras, and Nicaragua have the next lowest production cost; the Dominican Republic has the highest production cost. (Honduras's production and TRQ allotments are not representative in this year; for an accurate picture of Honduras's sugar production, examine the data from previous years.) Guatemala has the largest production volume; all other CAFTA countries produce substantially less raw cane sugar.

Table 2: Largest Producers (by volume) of Raw Cane Sugar, FY 2003/2004

Country	Production Volume (metric tons)	Production Cost Rank	TRQ Allotment (metric tons)	TRQ Actual (metric tons)	Imports under Other Sugar Programs (metric tons)	Miles from United States	In-Quota Tariff Rate (US\$/lb.)
Brazil	386,232,000	1	152,691	143,845	0	4,784	0.625
India	289,630,016	9	8,424	8,418	0	7,808	0
Thailand	64,407,744	3	14,743	14,743	0	9,038	0
Mexico	45,126,500	12	7,258	1,274	0	2,086	0
Colombia	36,600,000	2	25,273	25,283	81,321	2,480	0
Australia	36,012,000	1	87,402	62,873	0	10,627	0.625

Source: Data are from Economic Research Service, U.S. Department of Agriculture.

Table 3: CAFTA Countries, FY 2003/2004

Country	Production Cost Rank	Production Volume (metric tons)	TRQ Allotment (metric tons)	TRQ Actual (metric tons)	Imports under Other Sugar Programs (metric tons)	Miles from United States	In-Quota Tariff Rate (US\$/lb.)
Costa Rica	6	3,923,870	15,796	15,796	81,321	2,240	0
Dominican Republic	7	5,036,272	185,335	134,471	0	1,552	0
El Salvador	4	4,531,531	27,379	27,379	36,900	2,072	0
Guatemala	2	17,500,000	50,546	50,546	172,285	2,056	0
Honduras	6	4,200,000	10,530	458*	3,440	2,000	0
Nicaragua	6	3,602,840	22,114	19,425	11,878	2,101	0

Source: Data are from Economic Research Service, U.S. Department of Agriculture.

Additional Potential Impacts of CAFTA

Market Access for CAFTA Countries

With the implementation of CAFTA, the office of the U.S. trade representative (USTR) has stated that increased sugar imports from Central America and the Dominican Republic would amount to less than 0.25 percent of total annual U.S. trade with these countries (USTR 2005). Even though the change in the overall percentage of trade with these countries is small, U.S. sugar market access will increase for CAFTA countries. In the first year of the agreement, the USTR estimated that increased market access will amount to about 1.2 percent of current U.S. sugar consumption, up to 107,000 metric tons of raw cane sugar; in year 15, it is estimated that increased market access will amount to 1.7 percent of U.S. sugar consumption, up to about 151,000 metric tons of raw cane sugar (USTR 2005). Over the next several years these countries will be allotted increased TRQs but no reduction in over-quota tariff rates. For the Dominican Republic, TRQs will increase 10,000 metric tons in the first year, and 2 percent annually every year after that (Olson 2005). In addition to TRQs, the United States will create a quota for Costa Rican special goods (organic sugar), not to exceed 2,000 metric tons annually (Olson 2005).

Although the in-quota exports to the United States are duty-free, the second-tier tariff will initially remain in effect. After five years of CAFTA's implementation, the second-tier tariff will be 10 cents a pound. After 10 years, it will be 5 cents, and after 15 years, zero. Beginning in 2008, Mexico will also have unlimited sugar export rights to the United States.

CAFTA's increase in market access has the potential to affect not only the volume of exports allowed from CAFTA countries to the United States, but also many other aspects of the U.S. sugar program.

CAFTA's Impact on the Price of Raw Cane Sugar

As more sugar is imported into the United States, the wholesale price of sugar decreases. As the price decreases, domestic consumption increases. One would expect the price decline to lead to a decrease in sugar acreage in the United States. In the past,

however, beet and cane sugar production have been insensitive to price changes (elasticity is 0.22 for sugar beets, 0.11 for sugar cane, and -0.39 for domestic consumption). If the sugar price were to drop below 20 cents a pound, it is predicted that the elasticity of the U.S. sugar supply would increase (Koo et al. 2003).

The world market price for sugar is about 8 cents a pound, slightly more than half the world average cost of production. The U.S.-supported domestic price of sugar is about 21 cents a pound. Countries that export to the United States receive the U.S. supported price for their sugar. There is only one country, Brazil, that has a domestic wholesale price lower than the world price.

Wholesale refined sugar prices to the U.S. farmer dropped by 20.5 percent during 1996–2004, whereas consumer prices increased by nearly 3 percent (Olson 2005). This gap illustrates the disparity between price changes for farmers and consumers.

CAFTA's Impact on Marketing Allotments

CAFTA may also affect marketing allotments for U.S. sugar processors. The secretary of agriculture "will strive to establish an overall allotment quantity that results in no forfeitures of sugar to the Commodity Credit Corporation under the sugar loan program" (USDA 2003, 2). The planting of beets and sugar cane is not restricted, but if processors exceed their marketing allotment, they must store the excess sugar at their expense. In the 1996 Farm Bill, Congress removed marketing allotments but later reestablished them in the 2002 Farm Bill, hoping to increase the price of U.S. sugar.

These marketing allotments are based in part upon the volume of imported sugar used for food (USDA 2003). Thus, as CAFTA increases U.S. sugar market access for many sugar-producing countries, the U.S. sugar program may potentially face an increase in sugar from CAFTA countries that results in a level of imports above the so-called trigger level.

The 2002 Farm Bill set the trigger level at 1.39 million metric tons of total sugar imports. If imports are below this amount, then marketing allotments for the U.S. sugar program are unaffected. But some fear that increased CAFTA imports, together with sugar imports under NAFTA, could surpass the trigger level. If this occurs, the USDA would no longer have the authority to distribute marketing allotments. Sugar producers would be able to produce and sell unlimited amounts of sugar. Production would likely increase, and U.S. sugar prices would fall.

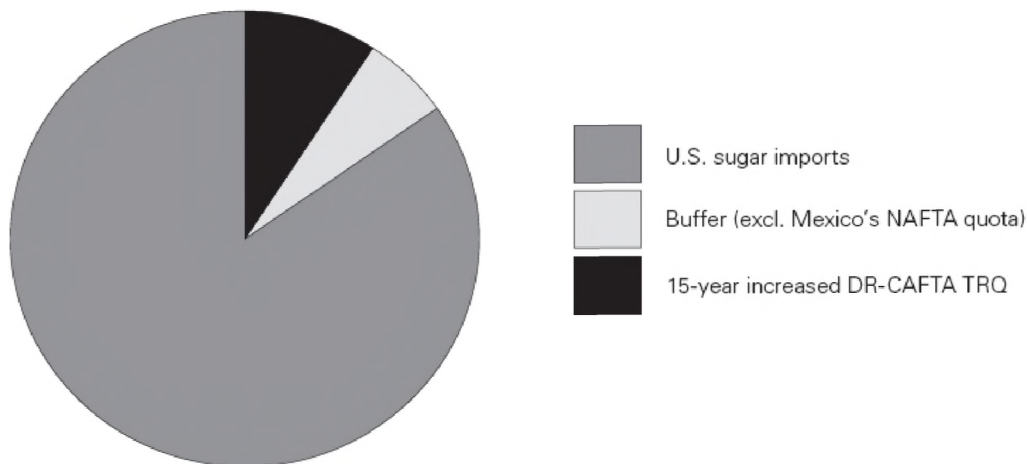
If all countries use their new quotas under CAFTA, then the buffer below the trigger level would remain at 98,000 metric tons (Figure 2). If, however, new trade agreements are established or if Mexico uses its full sugar export quota, then total sugar imports into the United States would surpass the trigger level. According to Olson (2005, 12), "If imports exceed the trigger level and marketing allocations were suspended, then increased domestic production would combine with the release of

currently blocked sugar reserves to flood the market and collapse the domestic price of sugar."

CAFTA's Impact on U.S. Sugar Industry Jobs

If CAFTA leads to increased production of sugar outside the United States and decreased sugar production within the United States, many argue that the loss of jobs from the decline of this industry will be insignificant. Although production of sugar in the United States has been increasing, employment in this sector has declined since 1989. In 2003 only 52,000 workers were employed in the sugar industry (farmers and processors), generating approximately US\$5.7 billion in sales. Of the more than 2 million farms in the United States, fewer than 6,000 (0.03 percent) contained sugar beets or cane. If sugar continues to benefit from government protection, Markheim (2005) argues instead that jobs in the sweetener industry (which employs 10 times as many people as the sugar industry) will be threatened.

Figure 2: No-Cost Sugar Policy Jeopardized by CAFTA



Source: Olson 2005.

Questions and Issues to Consider

- If TRQ allocations are eliminated, will poor countries be able to retain their access to the U.S. market?
- What will happen to high-cost producers if some low-cost producers are allowed duty-free access under CAFTA or other regional trade agreements?
- If TRQs were eliminated, would developing countries be forced to compete with the lowest-cost producers who now have a greater share of the market?
- Are preferential trade agreements just a stepping stone toward greater liberalization?
- What happens when powers are unequal? For example, what if CAFTA countries are more dependent on the United States than the United States is on CAFTA? What might this imbalance mean for labor and environmental standards?
- Why would the National Corn Growers Association choose to support CAFTA?
- If the U.S. price of sugar falls to about the world market price, will countries lose a large share of the U.S. domestic market? Some countries, like Australia, Brazil, South Africa, and Thailand, may be able to produce more and export more to make up for the price difference, but what will other countries do?
- If the U.S. market is deregulated and some developing and low-income countries no longer have the share of the U.S. market they depend on, what are some alternatives?
- What should TRQs be based on? Should they seek to maximize development opportunities in poor countries? If so, what criteria should selection be based on (for example, a country's per capita income)?
- How will other future trade agreements potentially affect low-income sugar-exporting countries?
- All WTO countries are able to use a safeguard clause within a trade agreement. The USTR (2005) explains this option as follows: "The [CAFTA] Agreement also includes a mechanism that allows the United States, at its option, to provide some form of alternative compensation to CAFTA country exporters in place of sugar imports. That allows the United States to restrict imports eligible to enter under the CAFTA if the U.S. sugar program is threatened, and instead provide equivalent benefits to the CAFTA countries to make up for the lost access." The safeguard clause was developed to protect a country's market system, but because it requires compensation, it is seldom used in practice. Instead, subsidies and distorted trade agreements are often the norm to sustain a country's market system. What may be a more effective alternative to these current practices?
- Are tariff rates so high that they are prohibiting trade? In the case of TRQs that were meant to do away with direct quotas, the out-of-quota tariff rate is so high that for a sugar-exporting country, it is not worth sending sugar to the United States above its in-quota allotment.
- Are regional trade agreements just an easy way out for countries that do not want full liberalization of their market? Does the agreement mention further liberalization in the future? What countries are included in the trade agreement? It is possible that countries excluded from the agreement will also be hindered from future trade with countries within the free trade agreement. In other words, do free trade agreements divert trade away from non-member countries?
- The rule of origin clause specifies the share of the total value of a commodity (such as raw materials) that must originate in either the exporting country or the importing country. This requirement can sometimes increase costs for developing countries, as

they may be forced to buy raw materials from the United States at increased prices (rather than a nearby country that may produce materials at a much lower cost). Many times there are “cumbersome measures to verify that textiles/apparel are made locally and additional safeguard measures that limit the possible market access gains” (Third World Network 2005, 4).

- How many years will it take to reduce trade barriers and to reach the termination point of reduction at which market access remains constant? Is it the same for each country?
- Are proposed export and import levels under the new trade agreement significantly different from prior levels? Who is gaining access, and who is losing access to export markets? Why are some countries gaining a greater share of the market than others? Most important, what are export and import values based on? With sugar imports into the United States, for example, TRQ allotments are based on historical trading patterns during 1975–1981. This was a time of extremely high sugar prices; thus many countries included in sugar trade agreements with the United States are actually high-cost producers.
- Many free trade agreements state that the developing country must provide reciprocal market access to the partner country in the agreement. If reciprocal market access were required, what may be the impact on developing countries?
- In some trade agreements, “sensitive products” are excluded or contain different provisions from the rest of the trade agreement. For example, the Everything But Arms agreement between the European Union and least-developed countries provides duty-free access to EU markets, with the exception of bananas, sugar, and rice, which are undergoing alternative (and slower) phase-in periods. These products are considered sensitive because increased imports of these products have the greatest ability to disrupt domestic markets.

- How are labor and environmental standards clauses written? Some speculate that these trade agreement standards can actually become just another trade barrier, restricting the export of a good from a developing country. Although labor and environmental standards are extremely important, caution must be taken to make sure they are not being used as simply another impediment to trade.

Assignment

Your assignment is to develop a set of policies under CAFTA that will satisfy all stakeholders. Discuss the policy issues with regard to alternative import mechanisms under CAFTA and which stakeholders might support or resist these policies. Justify your recommendations, and assess the consequences for the stakeholder groups.

Additional Readings

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